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REPORT ON UNCTAD'S ASSISTANCE TO THE PALESTINIAN PEOPLE

Prepared by the UNCTAD secretariat

Executive summary

The intensification in 2002 of the crisis in the occupied Palestinian territory and the recurrent border closures of the West Bank and Gaza have resulted in precipitous declines in national income, destruction of public and private sector infrastructure, and widespread disruption of Palestinian economy activity for much of the year. In the eighteen months since October 2000, the Palestinian economy has lost the equivalent of over half of its annual gross domestic product, unemployment has increased threefold, and poverty has risen substantially, with more than two-thirds of Palestinian households living below the poverty line. The Palestinian economy is now set on a path of "de-development", with serious ramifications for its public finances, trade balance, saving-investment gap and social services. The situation in the occupied territory is a telling example of "complex humanitarian emergencies", where vulnerability is great and the impact on the productive capacity, institutional infrastructure and the economy as a whole is severe. This economic and humanitarian crisis is once more forcing the Palestinian Authority into heavy dependence on donor support for maintaining its basic activities, while diverting attention from long-term development goals and activities.

The realities on the ground have imposed new priorities, which require promoting dynamic synergies between rehabilitation, reconstruction and strategic development needs. This framework will guide UNCTAD's technical assistance programme in the short and medium term. Despite increasing difficulties in the provision of technical assistance, UNCTAD was able to initiate a new research project in 2002, while also achieving concrete progress on five other capacity-building projects. In consultation with Palestine, the secretariat is examining possibilities of initiating targeted technical assistance in new areas: food security and commodity trade; trade logistics and facilitation; trade promotion; trade policy and preferential market access; and investment promotion.

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I. DEVELOPMENTS IN THE PALESTINIAN ECONOMY, 2001-2002

1. The crisis in Israeli-Palestinian relations since September 2000 has drained the economy of the occupied Palestinian territory of its most vital resources and rendered it increasingly weak in the face of new pressures.[1] Through losses to national income and the degradation of physical and institutional infrastructure, the economy has suffered setbacks that pose major challenges to the recovery and reconstruction programme that must follow. This is a task that acquires greater urgency in the context of realizing the vision affirmed by the United Nations, in Security Council Resolution 1397 (2002), of a region where two States, Israel and Palestine, live side by side within secure and recognized borders.

A. The economic consequences of the conflict since 2000

1. The 2002 escalation: a new crisis after 18 months of steady deterioration

2. By the most conservative estimates, the recent crisis cost the Palestinian economy $2.4 billion in gross national income (GNI) between October 2000 and March 2002. These direct losses over 18 months were equivalent to around 40 per cent of 1999 GNI and over half of 1999 gross domestic product (GDP), and they were compounded by at least $305 million in infrastructure losses. Real GNI per capita declined by 12 per cent in 2000, and by a further 19 per cent in 2001. By 2001, Palestinian GNI was estimated at $4,200 million, down from $5,500 million in 1999 (see table 1). As a result, between 40 and 50 per cent of the population is now living below an estimated poverty line of $2 per person per day.[2] In terms of deterioration of household income, it is estimated that the income of around 67 per cent of households has fallen below an estimated poverty line of $350 per household per month.[3] The income falls can be explained mainly by the recurrent internal and border closures in effect since October 2000, entailing increasingly restrictive measures on the movement of goods and persons both within and between the West Bank and the Gaza Strip and between these areas and the rest of the world. The immediate effects of those measures were the disruption of internal and external trade activities and loss of job opportunities within the occupied territory and in Israel. This raised the unemployment rate from 10 per cent in September 2000 to around 29 per cent by the end of March 2002, leaving more than 200,000 Palestinians without any work.[4]

3. The escalation of the crisis in 2002, in particular since the start of the Israeli military attack on areas under Palestinian Authority (PA) jurisdiction,[5] aggravated the widespread Palestinian economic recession, bringing the economy to the brink of collapse. Especially important are the tightened mobility restrictions since April 2002, including round-the-clock curfews, destruction of public and private property and the disruption of all facets of economic and social activity.[6] In addition to the loss of jobs in the domestic economy, the flow of Palestinian workers to Israel and its settlements in the occupied territory has declined sharply, raising the total losses in income generated by those workers since October 2000 to an estimated $757 million by the end of April 2002, equivalent to around 20 per cent of annual GNI.[7] Production activities in manufacturing, construction, commerce and public and private services have been further impaired, and external trade slowed considerably, equivalent to a contraction in the domestic output of the Palestinian economy by about 75 per cent during April 2002 alone.[8]

4. Basic utilities and physical infrastructure such as water, electricity generation facilities and grids, solid waste disposal stations, and road networks, as well as public and private institutions, were damaged during the incursions, generating an estimated $360 million in direct losses in April 2002.[9] Losses accrued to: private assets in the form of buildings, equipment and inventory (estimated at around $97 million); physical infrastructure (around $88 million, of which $64 million involved road networks); private housing ($66 million); cultural heritage ($48 million); PA assets, including Ministries and municipalities ($20 million); public and private cars ($6 million); and NGO and private social services ($56 million).

5. To maintain their continued operation in crisis conditions, Palestinian enterprises resorted to scaling down production and laying off employees, while some suspended their activities until stability could be attained. Others were forced to shut down completely, having been increasingly isolated from their target markets by the closures. This is especially the case of the once-promising tourism sector, which registered a 90 per cent decrease in commercial and service activities over the period September 2000–December 2001. The construction sector showed a similar decline in activities, owing to the suspension of infrastructure projects. Reduced private savings, shortages in raw materials and increased uncertainty also affected residential construction. The agricultural sector faced particularly substantial pressures, as the impact of closures was compounded by the bulldozing and uprooting of 17 per cent of cultivated land and almost a half a million olive and fruit trees, leading to a 70 per cent drop in the sector's output over the same period.[10]

6. Meanwhile, the trade sector's performance deteriorated further, with agriculture estimated to have lost around 30 per cent of its potential exports in 2001 and the manufacturing sector some 24 per cent.[11] At the same time, mobility and other restrictions have raised the already high transaction costs to prohibitive levels, as transport prices within the West Bank increased by around 15 per cent between September 2000 and December 2001 and continued to grow with every tightening of the closures.[12] Even prior to the crisis, transport costs associated with international trade were high, estimated at between $500 and $630 per shipment to/from Jordan and at between $600 and $630 per shipment to/from Egypt.[13] The resulting disruptions have had a drastic influence on both exports and domestic expenditure and imports: between 1999 and 2001, exports declined by an estimated 13 per cent, while imports contracted across the board by around 32 per cent.[14]

7. The closures of the territory have also caused shortages of food supplies, as farmers in rural areas were unable to market their products, lacking access to main cities and surrounding villages in the West Bank and Gaza. This has caused sharp variations in food prices between the West Bank and Gaza, where food production is concentrated. In particular, the combined effects of falling income and transport bottlenecks have depressed food prices in Gaza, while the relative scarcity of food supplies in the West Bank have exerted upward pressures on the prices of the same items. By the end of 2001, food prices in the West Bank were 10 per cent higher than those in Gaza.[15] At the same time, the economy's heavy reliance on imports for staple foods, the lack of efficient marketing channels and farmers' limited access to credit threatens further deterioration in food security.

8. In the financial sector, although the number of banks and branches operating in the territory has remained unchanged since 2000,[16] the crisis has impacted negatively on financial intermediation. The lending-to-deposit ratio declined from 41 per cent in September 2000 to around 38 per cent in September 2001, as total deposits decreased by 9 per cent from

$3,686 to $3,360 million, reflecting the decline in household income and business revenues. The value of outstanding loans registered a 16 per cent drop in view of the increased level of economic risk. Credit to the private sector declined by 3 per cent over the same period, as compared with 32 per cent growth between 1998 and 1999, indicating concern among banks over the future prospects of Palestinian enterprises. This masks an uneven distribution of credit in favour of the services sector as compared to credit to the agricultural sector, manufacturing and construction, all of which experienced declines.[17]

Table 1

Palestinian economy (West Bank and Gaza Strip) – Key indicators 1994, 1997-2001

Year	1994	1997	1998	1999	2000	2001
Generation of resources *(Millions of current US$)*						*(estimates)*
Gross domestic product (GDP)	2 625	3 882	4 157	4 622	4 213	*3 739*
Net factor income	471	512	854	879	987	*461*
Gross national income (GNI)	3 096	4 394	5 011	5 501	5 200	*4 200*
Net current transfers	559	340	372	268	n.a.	n.a.
Gross national disposable income (GNDY)	3 655	4 734	5 383	5 769	n.a.	n.a.
GDP per capita *(thousands of US$)*	1 274	1 508	1 549	1 652	1 442	*1 220*
GNI per capita *(thousands of US$)*	1 503	1 707	1 868	1 966	1 808	*1 392*
Use of resources *(percentages)*						
Consumption/GDP	127	119	*115*	*114*	n.a.	n.a.
Investment/GDP	37	37	40	39	n.a.	n.a.
National savings/GDP	*-9*	*-6*	6	5	n.a.	n.a.
Savings-Investment/GNDY	*-32*	*-35*	-26	-28	n.a.	n.a.
Trade balance/GDP	-64	-56	-55	-53	-56	*-47*
Memorandum items						
Population *(thousands)*	2 060	2 574	2 684	2 798	2 922	*3 064*
Labour force *(thousands)*	464	554	576	599	641	*672*
Employed in Israel *(thousands)*	*70*	77	119	135	95	*65*
Unemployed *(thousands)*	62	128	86	79	93	*173*
Unemployed/labour force *(percentages)*	13	23	15	13	15	*26*
Current budget balance/GDP *(percentages)*	-1.1	-1.1	1.4	1.1	-1.4	*-2*
Total aid disbursements/GNI *(percentages)*	16	12	7	9	11	*22*

Sources: Data for 1994 are from Palestinian Central Bureau of Statistics (PCBS), *National accounts*, 1994; Data for 1997-1999 from PCBS, *Statistical abstract of Palestine No. 2*, November 2001; Data for 2000-2001 are from PCBS, *Impact of the Israeli Siege on National accounts indicators*, preliminary report, April 2002, while trade indicators for the period 1999-2001 are estimates based on Vadirieso, R.A. et al. *West Bank and Gaza: Economic Performance, Prospects, and Policies*, Washington, D.C., IMF, 2001, Table 4.1, p.85, and on Economist Intelligence Unit, *Country Report: Israel and the Palestinian Territories*, April 2002. Fiscal data are based on Alnoso-Gamp, P. et al. *West Bank and Gaza: Economic Development in the Five Years Since Oslo*, Washington, D.C., IMF, 1999 and Vadirieso, R.A. et al. "*West Bank...*", while data on ODA is based on Alnoso-Gamp, P. et al. "*West Bank...*" and World Bank, *Fifteen Months - Intifada, Closures and Palestinian Crisis*, West Bank and Gaza Resident Mission, Palestine, March 2002.

2. A cycle of "de-development"

9. Direct economic losses are compounded by the profound changes that have taken place in the functioning of economy as a result of the closures, which are unlikely to be reversed easily once stability is attained. In particular, the purchasing power of the

Palestinian population has been depleted as households have adopted different coping strategies to withstand the reduced levels of income. This has entailed the rationalization of consumption, the suspension of payment for many public services, and increased recourse to savings and other assets, including selling of property. By 2002, it appears that the protracted conflict had exhausted those coping strategies, rendering dependency on emergency support in the form of food packages and financial support more common. This has led to the expansion of the informal economy, especially in the West Bank villages and to some extent in the Gaza Strip, as impoverished households have resorted to survival activities to maintain their subsistence.[18]

10. The situation prevailing in the occupied Palestinian territory is a telling example of "complex humanitarian emergencies" associated with conflicts, where coping strategies are exhausted so that vulnerability is greater and the impact on the productive capacity, institutional set-up and confidence in the economy is severe.[19] Prolonged occupation and the protracted economic crisis since 2000 have set the Palestinian economy on a path of "de-development",[20] posing threats to its short and medium-term viability, with serious ramifications for the saving-investment gap, the trade balance and public services.

11. While the private sector and most households have exhausted their savings, declining household incomes and the economy's weakened supply capacity means that domestic savings will fall in absolute terms in the coming few years. Total market capitalization is estimated to have dropped by 40 per cent between 2000 and 2001.[21] In the absence of political stability, private investment will continue to decline, while restrictions on mobility will discourage investments in activities requiring considerable amounts of capital and those with significant transport requirements.

12. It is unlikely that efforts to reactivate exports will generate positive results in the medium term, especially in view of enterprises' weakened production capacity, prohibitive transport and transaction costs, and the difficulties of getting access to finance for local enterprises seeking to resume their activities. The banking sector is becoming more stringent in offering credit to local enterprises, while private lending from abroad will be even more difficult with the loss of confidence in the Palestinian economy.

3. Impact on PA institutional capacity

13. The destruction of public infrastructure aside, the PA's administrative and planning capacity has been seriously undermined by heightened uncertainty, repeated disruption of government services and the loss of part of its institutional memory. The databases of a number of governmental departments were subjected to considerable losses, with computers, software and vital records either damaged or stolen in the key Ministries of Education, Interior and Finance. The escalating budgetary pressures are also threatening PA payrolls and operating budgets, while the tight closure prevents most staff from reaching work places.

14. The PA is awkwardly placed to confront the threat of maintaining basic services because it is already effectively bankrupt and increasingly dependent on donor aid to maintain current expenditures. The real threat to the PA's capacity to maintain basic services in both the immediate future and the medium run stems from its weakened revenue-raising capacities, the significant erosion of the economy's tax base and the diminishing income from fees on public services. Furthermore, the inability of the PA to access tax revenues collected

on its behalf by Israel meant an additional loss of $507 million by the end of February 2002.[22] PA tax, customs and excise revenues declined on a monthly basis by almost 80 per cent from $88 million in the third quarter of 2000 to $20 million in 2001. This raised the budget deficit from $19 million in September 2000 to $73 million in December 2001, with a much larger deficit expected for 2002. This has increased the pressure for austerity measures by the PA to rationalize expenditures, including cutting salaries, delaying payment of bills and borrowing from commercial banks. By the end of 2001, the PA had accumulated around $430 million in arrears, mainly to commercial banks, with the result that it can no longer resort to domestic borrowing to finance its activities.[23] This means that the PA will be fully dependent on donor support for maintaining its activities at least over the current fiscal year. To the extent that the donor community shifts to loan-based aid, this would increase debt obligations and could further strain the PA's ability to maintain social services. Already, PA public debt has risen from $600 million in 1999, equivalent to 13 per cent of GDP, to $1.2 billion by mid-2002[24], equivalent to around 34 per cent of projected GDP,[25] a proportion which is likely to register further increases in coming years in view of declining GDP and new public debt obligations.

4. Impact on official development assistance

15. Over the period 1994-June 2000, the Palestinian economy received foreign aid amounting to $3 billion, equivalent to around 14 per cent of GNI per annum and $175 per capita.[26] Indeed, donor disbursements over the period 1994-1998 of $2.3 billion exceeded the $2.2 billion pledged for that period at the first donor conference held in 1993. Almost 82 per cent of aid was provided in the form of grants, with the members of the European Union together providing 42 per cent of total aid and the United States of America standing as the largest single donor, with 15 per cent of total aid.[27] The allocation of these funds reflects a gradual shift towards funding development projects in physical infrastructure, health and education, while budgetary support dropped from 31 per cent of total aid in 1994-1995 to 4 per cent in 1999, only to rise again sharply since.[28]

16. Since 2000, increasing damage has been inflicted upon donor-funded infrastructure projects, an example being the destruction of facilities at Gaza International Airport and the Gaza Seaport project.[29] Meanwhile, the humanitarian crisis is diverting donors' attention again to budgetary support and emergency assistance, which absorbed around 80 per cent of disbursements over the period September 2000-December 2001. This crisis has also been accompanied by an increase in foreign aid. Total disbursements rose by 93 per cent in 2001 and commitments by 77 per cent compared with 1999, bringing total disbursement to $929 million by the end of 2001 and commitments to $1,228 billion. These funds were mainly grant-based, with the League of Arab States and the European Union providing 47 per cent and 26 per cent of total aid respectively and the United States of America providing 20 per cent.[30]

B. Development challenges facing public policy in trade, finance and development

1. Challenges to the PA's capacity to manage the economy

17. Despite the relatively limited economic policy options accorded by Israeli-Palestinian accords since 1994 and the lack of political stability, the PA succeeded in establishing a functioning government with a national mandate that was able to create much of the needed

institutional and regulatory framework for improving living conditions and for stimulating economic growth in the Palestinian territory. Indeed, available statistics for the period 1994-1999 show an upward trend in key social and economic indicators. Most notable are the following: the 76 per cent increase in GDP over the period despite continued volatility; the improvement in per capita GDP from $1,274 in 1994 to $1,652 in 1999; the reduction in the proportion of the population living under an estimated poverty line of $2 per person per day from 27 per cent in 1996 to 23 per cent in 1998; continued increases in net enrolment ratios in primary and secondary education; and significant improvements in health, public utility and other human and social development indicators.[31]

18. In themselves, these achievements lent credibility to the role of the PA and provided grounds for confidence in its readiness and potential to assume national government functions. Even prior to the crisis, the PA had shown a commitment to strengthening and improving the performance of public institutions. The PA established an inter-Ministerial committee in 1999 to develop public institutions, and in 2000 it introduced a range of improvements in public finance management under the "Economic Policy Framework" (EPF), developed in collaboration with the International Monetary Fund. The EPF committed the PA to consolidation of all public revenues under one account, the modernization of tax collection and customs procedures to adhere to international standards, and divesting PA assets in private enterprises, estimated at $345 million by 2000. These efforts were supported by measures to promote private sector-led development, including an open dialogue with the private sector on economic policy-making and reform of the legal framework.[32]

19. Nonetheless, the PA's performance record shows that there remains room for improvement,[33] especially since recent developments have strained the PA's capacity to govern even further and exposed weaknesses to greater public scrutiny. At the planning level, the PA has yet to address the need for elaborating clear development vision and strategy, other than a general commitment to trade and financial liberalization and the creation of an enabling environment for private-sector, export-led development. Though some of these policy orientations are reflected in special legal or regulatory arrangements, they have yet to be embodied in operational development policies, since objectives are stated in generic terms and are not well connected with particular programmes, projects or short-range policy measures.

20. At the implementation level, the impact of the development programmes is undermined by differential competence levels within and between Ministries, weak executive capacity in translating priorities and goals into coherent action, and weaknesses in the budgetary process, especially with regard to the consolidation of fiscal accounts, causing fiscal leakage and delays in service delivery.[34] The high population growth rate of 5.1 per cent annually will generate a continually high demand for public services in the future, which has to be factored into the planning of civil service restructuring of the PA. For the moment there has been a freeze in PA employees and a 4 per cent cut in the nominal wage bill.[35]

21. Considering the magnitude of the challenges ahead, the key to enabling the PA to promote sustained recovery is the restoration of its capacity to manage the economy and to maintain basic social and public services. The ability of PA institutions to operate without Israeli intervention in areas under PA jurisdiction is a prerequisite for mounting any sustained development effort. The PA has already embarked on a financial and administrative restructuring of public institutions that goes beyond the downsizing of the civil service. In June 2002, the new PA Cabinet presented an integrated, 100-day programme for government

action, suggesting appropriate reform measures, including streamlining of the civil service payroll and guidelines for modernizing Ministries.[36] The recent crisis also prompted the PA Ministerial changes of June 2002, which entailed merging the Ministry of Economy and Trade with that of Industry, as well as the appointment of new Ministers of Education, the Interior, Finance, Justice, Labour, and Natural Resources and Tourism. Meanwhile, the PA is working on a comprehensive privatization plan, while the recent adoption of the Judiciary Law and the planned finalization of other measures, such as the Industrial Estates Law and Competition Law, will help to improve the regulatory environment.

2. A legacy of uneven economic performance

22. Regardless of how capable, streamlined and transparent the PA proves to be in the area of economic policy-making and management, it faces an economy beset by deep-seated structural weaknesses and imbalances. It should be recalled, however, that these weaknesses arise from the legacy of 35 years of occupation and distorted economic relations with Israel and isolation from regional and global markets, much more than from the experience of the limited, and by design provisional, interim period of self-government arrangements.

23. Previous reports by the UNCTAD secretariat have demonstrated that the Palestinian economy's growth during the period 1994-1999, as measured by increases in GDP and GNI per capita, masked an insecure base for sustained economic development. External resources continued to provide the driving factors of growth, and the economy showed heavy import dependence in obtaining raw materials and essential commodities, with Israel standing as the main source and sole route of supplies. The effect of this has been a marked saving-investment gap, a widening in the trade deficit and an increase of its ratio to GDP. The latter reflects weakening export capacity, unrestrained import growth (until 2002), and almost total dependence on foreign aid for financing development projects.[37] This has occurred despite the diversification of sources of income as the structure of the economy underwent substantial change. Agriculture's share of GDP dropped from an annual average of 17 per cent in 1991-1993 to 7 per cent by 2000, while that of services and industry grew from 45 per cent and 9 per cent to 54 per cent and 16 per cent respectively.[38]

24. The uneven performance of the Palestinian economy in recent years may be attributed above all to the lack of political stability and the persistent delays and shortcomings in the implementation of signed agreements, especially the 1994 "Paris Protocol on Economic Relations" between Israel and Palestine. This has prolonged an interim period (1994-1999) that was conceived as a temporary measure to permit a smooth transition to permanent economic arrangements. This de facto prolongation has increased the degree of uncertainty with regard to future arrangements governing the economy. The recurrent border closures constitute a major factor that has continuously eroded the impact of development efforts by paralysing economic activities over extended periods and increasing the economy's vulnerability to external shocks. The indefinite delay in the opening of the Palestinian seaport in Gaza and the tight restrictions governing operations of the Gaza International Airport have resulted in heavy dependence on Israeli facilities for participation in international trade.[39]

25. The adverse economic environment poses high risks for both public and private investment. These are increased by the unpredictability of production and trade under closure, as well as the high transaction costs generated by the complex procedures governing the

transport of Palestinian trade across the main borders with Jordan, Egypt and Israel. Furthermore, the PA's restricted jurisdiction over land and water has reduced the availability of natural resources needed for productive development.

26. The result has been an aggravation of structural weaknesses in the economy, as reflected for example in: (i) the stagnant level of private investment and its concentration in construction activities; (ii) the continued dominance of micro-enterprises with fewer than five employees, which account for 90 per cent of total establishments; (iii) the range of problems affecting small and medium-size enterprises (SMEs), including a paucity of managerial skills and of the experience needed to participate in trade; (iv) the composition of exports, whereby labour-intensive manufactured goods accounted for 42 per cent of merchandise exports in 1998; (v) the inability of the domestic economy to absorb more than 60 per cent of new entrants to the labour force;[40] and (vi) a fledgling financial system, with a thin capital market, a banking sector that is mainly engaged in short-term lending, and limited insurance services.[41]

27. Accordingly, there is a twin challenge for Palestinian development efforts: both recovery and reconstruction in the post-conflict situation need to be pursued against a background of prolonged disappointing economic performance.

3. A deficient trade regime and constrained market access conditions

28. The Palestinian trade regime, as defined under the terms of the Paris Protocol, has provided an inadequate basis for efficient Palestinian economic growth, entailing policies that are more responsive to the commercial interests of the much larger and stronger Israeli economy.[42] In addition to maintaining the range of subsidies, indirect taxes on certain imports and non-tariff barriers applied by Israel to protect its industries, without enabling the PA to exercise similar policies, the Protocol adopts Israeli regulations for imports from most third parties. Except for a limited group of products within specific quantities imported from Egypt and Jordan to which the PA can apply its own lower rates, Palestinian imports must be subjected to a floor of Israeli rates. This has rendered trade policies effectively identical to those of Israel, making it impossible for the PA to revise the level of taxes upwards (or downwards, except in cases just mentioned).

29. Accordingly, under the present trade regime, the PA must attempt to stimulate industrial development in a context of trade liberalization, which limits its policy space. In effect, the Palestinian economy, by virtue of its association with the Israeli trade regime, has to bear all the costs of trade liberalization inherent in World Trade Organization (WTO) membership, while having access to few of the benefits of liberalization and WTO accession. Notwithstanding the aforementioned shortcomings, the Protocol was intended to provide the Palestinians with opportunities to reap some benefits in the form of expanded trade and employment in Israel, as it was predicated on the free movement of goods and persons between the two territories. However, border closures in 1996-1997 and since 2000 have undermined such opportunities, and by so doing, have effectively set the limits for the Palestinian economy's development possibilities.

30. Furthermore, Palestinian preferential or free trade agreements with regional and international partners (e.g. Canada, Egypt, European Union, Jordan, United States of

America) remain largely unexploited, mainly owing to market access conditions that are not consistent with the economy's development needs. At the policy level, Palestinian exports are subjected to a variety of conditions (quotas, seasons and tariffs), even when granted preferential access. At the operational level, the lack of PA control over borders puts Palestinian trade at a disadvantage, as prohibitive transport and administrative costs inflate the prices of both the imports and exports transported through Jordan and Egypt.

31. For the immediate future and until permanent economic arrangements are reached between Israel and Palestine, the Paris Protocol will continue to limit the PA's scope for policy autonomy. However, the experience of the existing trade regime highlights the need for careful examination of the PA's future bilateral, regional and multilateral trade policy options in the context of a national strategic development vision, firmly rooted in Palestinian economic realities and interests.

4. The absence of a national currency

32. The absence of a national currency leaves the PA without the possibility of resorting to monetary and exchange rate policies to offset macro-economic disequilibria, and this is unlikely to change in the near future. Recovery efforts will have to proceed under the current arrangement, which relies upon three convertible currencies, the Israeli shekel, the Jordanian dinar and the United States dollar. Previous studies have indicated that this arrangement has contributed to the banking system's reluctance to extend long-term loans owing to risks due to the difficulty of matching the currency denomination of its assets and liabilities.[43] A national currency should thus be a central component in the design of a future Palestinian national economic policy.[44]

5. Tightened mobility restrictions, humanitarian crisis and poverty

33. The development-policy challenges to the PA would be complex enough even without intensified Israeli restrictions within the occupied territory. These include the establishment of "buffer zones" around the West Bank cities to separate them from Israel, thus entailing new restrictions on the movement of goods with/through Israel, as well as between cities in the West Bank and Gaza. According to arrangements announced in mid-2002, merchandise imports and exports will be authorized to pass only at certain border checkpoints and will have to be downloaded from incoming trucks and then reloaded into local trucks before proceeding to their final destination.[45] The Israeli authorities are also introducing a tighter system of permits for controlling the movement of Palestinians within the West Bank and Gaza and to Israel. Recurrent border closures and Israeli security preoccupations have led to the replacement of Palestinians by foreign workers, making it difficult to envisage restoration of the pre-conflict level of Palestinian labour flows to Israel.

34. The expansion and institutionalization of Israeli restrictions will certainly worsen the humanitarian crisis, since the economy's coping strategies have been overwhelmed by poverty. This renders attempts to address development needs particularly difficult, *inter alia* because emergency needs will still be evident even after the attainment of stability. The experiences of other war-torn economies show that food aid can distort prices and act as a

disincentive to domestic food producers.[46] Aid is nevertheless an indispensable component of the policy response to the current humanitarian crisis. In the longer term, the best way to reduce aid dependency will be to provide external resources at the level required to rebuild the economy's infrastructure and enable it to achieve self-sustained growth.[47]

6. Linking relief and development

35. While the level of aid is critical for supporting the reconstruction process, the quality of aid is equally important. At the policy level, the present approach to aid coordination is not directly linked to PA budget and development priorities. The Palestinian Development Plan (PDP), which until 2000 provided a framework for allocating foreign aid, focuses mainly on public expenditure, entailing a list of development projects with little indication of their implications for the public budget. However, the Plan has been overtaken by the imperatives of the recent crisis and its usefulness in the new circumstances is less evident. At the implementation level, there is a need to enhance coordination both among donors and within the PA, especially in the area of private sector development. Experience shows that the lack of coordination and consolidation among donor programmes has overburdened the PA with administrative work and undermined the impact of private sector development efforts.[48]

36. While the emergency humanitarian needs of poverty-stricken households will call for increased attention over the coming months, the depletion of the economy's coping strategies threatens long-term dependencies and increases vulnerability. Hence, there is a need for renewed development efforts to strengthen the economy's resilience, both at the household and industry levels. A top development policy priority following the immediate relief effort should be to moderate the impact of the economic effects of the conflict, especially through halting the declines in output and employment and creating the necessary conditions for jump-starting recovery. This requires promoting dynamic synergies between rehabilitation, reconstruction and strategic development needs.

37. In particular, rehabilitation efforts should aim at strengthening the economy's capacity to withstand the crisis, especially through emergency job creation programmes, while reconstruction efforts should dovetail with strategic development policies, *inter alia* targeting the root causes of economic vulnerability and offsetting the mechanisms through which their adverse effects occur.[49] In view of the economic impact of the conflict on exports and trade-related activities, special efforts should be made to restore export capacity, to re-establish financial and trade links with traditional markets, to develop new product lines, and to help industries penetrate new export markets.

38. The rebuilding of the PA's institutional capacity should include the revitalization of its tax collection capacity and rehabilitation of basic utilities and services. These efforts should be supported by active labour market policies to offset soaring unemployment rates, and renewed efforts to improve the deteriorating food security conditions that go beyond emergency food assistance. Programmes should also seek to assist troubled businesses, especially small and medium-sized enterprises, to resume their activities, with special attention paid to finding new markets and to ensuring access to credit. In the medium term, there should be efforts to re-orient Palestinian trade towards more balanced relations with Israel, especially by integrating the economy with regional and global markets. These efforts should include exploring alternative maritime transport arrangements in order to reduce Palestinian enterprises' heavy reliance on Israeli port facilities.

39. The new realities created by the protracted conflict have rendered previous development policies less responsive to the economy's needs. Of special importance here is the need to carefully reconsider the pace of, and policies related to, economic and trade liberalization. This stems not only from the private sector's weakened capacity to respond to market incentives but also from the deteriorating terms of trade of labour-intensive products, which raises the question of how best the Palestinian economy's industrial base should be modernized through a restructuring that emphasizes more technology-intensive products with higher value added.[50]

40. Such a "dynamic industrial policy" may necessitate resort to temporary measures of protection. These measures should be based on a thorough assessment of the different sectors' export potentials and development needs in order to allow for selectivity as far as possible. The protection should "aim at the support of certain industries at each point in time while reducing or eliminating support to others"[51] and its effects should be enhanced by policies at the sectoral level to attract foreign participation, where this is appropriate, and to improve the industries' technological capability.

II. UNCTAD'S TECHNICAL ASSISTANCE TO THE PALESTINIAN PEOPLE

A. Framework, objectives and operational activities under way

41. Designed to strengthen institutional capacity and support development efforts, UNCTAD's technical assistance to the Palestinian people has evolved since 1995 into a multifaceted and integrated programme of technical cooperation with the PA. Between 1995 and 2001, in close consultation with Palestine, UNCTAD provided technical assistance to the Palestinian people through 20 research-based technical assistance projects, drawing on the experience of the secretariat as a whole. With a view to bolstering Palestinian institutional development, and helping to create an enabling environment for private sector growth, UNCTAD technical assistance is guided by a set of interrelated strategies that are designed to achieve specific national development objectives identified by the PA within four programme clusters:

- Trade policies and strategies;
- Trade facilitation and logistics;
- Finance and development; and,
- Enterprise, investment and competition policy.

42. However, the protracted conflict since October 2000 has interrupted the Palestinian development process and rendered the provision of technical assistance increasingly difficult, especially in view of the deteriorating field conditions, tightened mobility restrictions, and restrictions on the access of UNCTAD experts. This has resulted in the suspension of training activities planned under the *Training programme in international commercial diplomacy - Phase II* and the postponement of the commencement of proposed advisory services and training activities under four projects: *Bilateral and regional trade arrangements; International procurement of strategic food commodities; Institutional capacities for Gaza Seaport; and Strengthening capacities of the domestic insurance sector.* Nonetheless, by deploying streamlined and selective operational activities, especially advisory and consultancy services, group training and technical support, UNCTAD was able to initiate a new project in 2002 and achieve concrete progress in five others already commenced.

43. Since 2000, UNCTAD's technical assistance to the Palestinian people has benefited from extrabudgetary support from the Governments of Italy, the Netherlands, Norway and the United Kingdom, as well as from the United Nations Development Programme (UNDP) and the World Bank. In designing and implementing its technical assistance, the secretariat has maintained contacts with relevant international organizations, especially UNDP, the United Nations Industrial Development Organisation, the UNCTAD/WTO International Trade Centre (ITC), the United Nations Special Coordinator for the Occupied Territories, the United Nations Relief and Works Agency for Palestine Refugees and the World Bank, as well as Palestinian and international research centres and civil society institutions.

1. Trade policy and strategy

44. UNCTAD's activities in this area entered a new phase in early 2002 with the initiation of a new project that aims at assisting the PA in developing and regulating the services sector,

while building capacity to conduct future bilateral and multilateral negotiations on trade in services. Following an advisory mission in mid-2001, project activities requested by the PA Ministry of Economy, Trade and Industry (MoETI) included the preparation of a national study on the services sector with a view to providing the PA with a policy framework for designing and implementing a "Master Plan for Developing Trade in Services" (MPDTS). The results of the study will be presented to relevant private and public institutions at a national forum within the context of the PA's National Trade Dialogue Project (NTDP) by the end of 2002. Follow-up activities still to be costed include assistance to MoETI in elaborating the MPDTS and preparing an action plan for its implementation.

45. Progress in this cluster was made under the issue of *Transit trade and transport for the PA*, with the preparation of two technical studies entitled "Transit Transport for Palestine" and "Regional Maritime Transportation Alternatives", which were presented to the PA in early 2002. MoETI is currently seeking funding for further advisory services in this area. While the UNCTAD secretariat will assist the PA in drafting transit transport framework agreements with its immediate neighbours, a detailed package of advisory and training activities would also be required, in coordination with relevant PA and private institutions.

2. Trade facilitation and logistics

46. The secretariat was able to continue advisory and training activities under the *Trade Point Palestine Ramallah (TPPR)* project that is being implemented in close cooperation with MoETI and the Palestinian Trade Centre (Paltrade), the private-sector host organization. Following a request by the PA, a TPPR Business Plan 2002-2004 was prepared by the secretariat and submitted in early 2002 in order to help TPPR further expand its customer base and sources of income, in addition to exploring new import and export market opportunities. Paltrade is currently preparing to implement the plan in close cooperation with UNCTAD. Fresh funding is sought for follow-up activities, including training and the extension of the operation of the Trade Point to cover Gaza.

47. Meanwhile, steady progress was achieved in the *Preparations for ASYCUDA - Phase I* project, which commenced in mid-2001 and is being implemented by the General Directorate for Customs and Excise of the PA and funded through the Palestinian Economic Council for Reconstruction and Development (PECDAR). Owing to the field difficulties affecting the organization of training activities and advisory services and damage to the ASYCUDA project office in Ramallah, the project completion date has been delayed. However, flexible modalities for technical and functional training, as well as the building of the system, were identified to enable the ASYCUDA++ prototype to be installed in the Customs Headquarters in Ramallah by September 2002. Meanwhile, the PA is seeking funds for Phase II of the project, which focuses on the provision of further training for the national team and the installation of the prototype system at three pilot sites.

3. Finance and development

48. In close cooperation with the PA Ministry of Finance (MoF), UNCTAD has taken the necessary measures to maintain its advisory and training services under the project

Strengthening capacities in debt monitoring and financial analysis (DMFAS). This included the dispatch to Gaza of two DMFAS experts to install the system, begin building the database and train MoF staff in its use. In addition, the secretariat is preparing to undertake a comprehensive study on debt strategies and policies that will provide the PA with a policy framework for guiding efforts in the areas of debt management and loan negotiations. Meanwhile, the secretariat is updating and further developing its Macroeconomic Simulation Framework of the Palestinian economy, for use by the secretariat and eventual installation in PA economic planning and policy research institutions.

4. Investment, enterprise development and competition

49. Following a brief suspension in 2001, technical assistance under this programme entered a new phase with the resumption of project activities under *Support for small and medium enterprise (SME) development (Empretec)* within the context of the MED2000 Programme. This entailed the establishment of a training and support capacity centre within the host organization, the Palestinian Banking Corporation, which assumed the responsibility for operating the project and integrating it into the regional and international Empretec network. Furthermore, a Management Advisory Committee was created to coordinate the project's activities with other ongoing donor-funded programmes targeting Palestinian SMEs and to ensure the project's sustainability beyond the initial funding cycle.

50. Meanwhile, the secretariat is in the process of preparing a comprehensive study on the Palestinian SME sector, including a statistical survey of the sector's salient features and needs, to be implemented in close cooperation with the Palestinian Central Bureau of Statistics (PCBS). The results of the study will be used for: (i) assisting Empretec staff in defining the Palestinian entrepreneurial profile and adapting follow-up services to the local business environment and the SME sector's needs; and (ii) assisting the PA in designing the needed policies for developing this sector and enhancing its contribution to economic growth.

B. UNCTAD's response to the Palestinian economic crisis

51. As mentioned in chapter I, the widespread humanitarian crisis raises the need to create dynamic synergies between the processes of rehabilitation, reconstruction and long-term development planning. Since UNCTAD technical assistance is mainly geared to addressing medium- and long-term institutional and other development needs, creating such synergies requires modifying certain ongoing projects to address acute economic needs as well as taking account of such needs in the design of projects in new areas which target medium- and long-term development. Guided by the findings of an UNCTAD assessment mission in May 2002, the secretariat is examining in close cooperation with the PA the possibilities of initiating targeted technical assistance in the areas indicated below.

1. Food security and commodity trade

52. Subject to resources availabilities, UNCTAD is ready to assist the PA in the design of: (i) financing mechanisms for farmers who are not involved in export activities; (ii)

export/import finance facilities; (iii) warehouse and related trade facilities; and (iv) training activities in international procurement and trade of strategic food commodities.

2. Trade logistics and facilitation

53. In the light of the findings of an UNCTAD study on alternatives for the PA in regional maritime transportation, the secretariat could further examine options for routing Palestinian trade through neighbouring seaports in the region, as well as the feasibility of establishing a temporary maritime landing facility in Gaza. At the same time, UNCTAD can advise the PA on installing an automated system for security clearance of goods at the borders with Egypt and Jordan so as to reduce clearing time and damage caused by security control operations.

3. Trade promotion

54. UNCTAD will continue to assist Paltrade/TPPR in preparing and disseminating information on export opportunities, especially at the regional level. This includes linking Palestinian enterprises with regional export promotion agencies that are ready to assist Palestinian exporters in regional and global markets. Moreover, in collaboration with ITC, UNCTAD can assist the PA in developing appropriate strategies for improving supply-chain management.

4. Trade policy: preferential market access

55. UNCTAD could assist the PA in developing an agenda for obtaining the special and differential treatment accorded to the least developed countries. The need to extend such treatment to the occupied Palestinian territory was recognized by the General Assembly as early as 1988 in resolution 43/178, while the economy's development continues to meet structural impediments to growth, many of which are common with LDCs. Meanwhile, as Palestine considers the possible benefits of observer status at the WTO, the UNCTAD secretariat's previous advisory services to the PA in the area of trade policy can serve as a useful basis for further technical assistance that it may require.

5. Investment promotion

56. The Palestinian Investment Promotion Agency (PIPA) is developing new approaches to respond to the private sector's emergency needs and has requested UNCTAD's assistance in revising the PIPA business plan and in developing some of the agency's core programmes. UNCTAD has also expressed its readiness to assist PIPA in developing a consistent framework for stimulating domestic investment and attracting foreign direct investment.

Notes

[1] In accordance with the relevant General Assembly resolutions and decisions, references in this report to the occupied Palestinian territory pertain to the Gaza Strip and West Bank, including east Jerusalem (for purposes of brevity, the term "Palestinian territory" is also used as appropriate); the term "Palestine" used in this report refers to the Palestine Liberation Organization, which established the Palestinian Authority (PA) following the 1993-1994 accords with Israel. Unless otherwise mentioned, data on the Palestinian economy in this report apply to the Gaza Strip and West Bank, excluding east Jerusalem.

[2] World Bank, "Fifteen Months - Intifada, Closures and Palestinian Crisis", West Bank and Gaza Resident Mission, Palestine, March 2002.

[3] Palestinian Central Bureau of Statistics (PCBS), "Impact of the Israeli Measures on the Economic Conditions of Palestinian Households on the Eve of Israeli Incursion", 4th round, January-February 2002, Palestine, April 2002.

[4] According to PCBS, "Labour Force Survey", first round, January-March 2002, Palestine, the number of Palestinian workers in Israel ranged between 125,000 and 130,000 workers on the eve of the conflict. This number has since declined by over 50 per cent, as only 50,000 workers now work in Israel, according to the World Bank, "Fifteen Months…".

[5] See Security Council resolution 1402 (2002) of 30 March 2002 and General Assembly resolution ES 10/10 of 7 May 2002.

[6] Since March 2002, Gaza has been divided into three areas, while the West Bank cities have been separated by permanent checkpoints.

[7] PCBS, "Impact of the Israeli Siege on National Accounts Indicators", preliminary report, Palestine, April 2002

[8] PCBS, "Impact of the Israeli Siege...".

[9] The Local Aid Coordination Committee (LACC), press release, Jerusalem, 15 May 2002.

[10] The Palestinian Economic Council for Development and Reconstruction (PECDAR), "People Under Siege: Palestinian Economic Losses, September 2000-September 2001", Palestine, September 2001. By the end of February 2002, the Israeli forces had destroyed 31,283 hectares of agricultural land and 485,665 trees, leaving 5,243 farmers without any source of income. PA Ministry of Agriculture, "Report on Palestinian agriculture losses due to recent Israeli actions: September 2000- February 2002", Palestine.

[11] World Bank, "Fifteen Months…".

[12] PCBS, "Monthly Consumer Price Index", Quarterly Reports, different issues, Palestine, 2000-2001.

[13] UNCTAD, "Cooperation between the Palestinian Authority, Egypt and Jordan to entrance subregional trade-related services", UNCTAD/GDS/SEU/3, Geneva, 14 February 2000. For further discussions on transport arrangements and their impact on transaction costs, see R.A. Vadirieso, et al. *West Bank and Gaza: Economic Performance, Prospects, and Policies*, Washington, D.C., IMF

[14] The figure for Palestinian trade deficit in 2001 is based on estimates in R.A. Vadirieso, et al. "West Bank and Gaza…", table 4.1, p.85, and Economist Intelligence Unit, "Country Report: Israel and the Palestinian Territories", April 2002.

[15] PCBS, "Monthly Consumer Price Index".

[16] This includes 22 banks and 115 branches.

[17] Palestinian Monetary Authority (PMA), Statistical Bulletin, No. 40-42, Palestine, 2001.

[18] UNSCO, "Paying a Price: Coping with Closure in Jericho, Gaza City and in Two Palestinian Villages", Gaza, January 2002.

[19] See Fitzerald, S., *War and Underdevelopment*, Oxford, Queen Elizabeth House, 2001, Chapters 1 and 9.

[20] Sara Roy first used this term to analyse the economic performance of the Gaza strip in "The Gaza Strip: The Political Economy of De-Development", Washington, D.C., Institute for Palestine Studies (IPS), 1995.

[21] Center for Private Sector Development (CPSD), "The state of the private sector", Palestine, 2001.

[22] These taxes include import taxes collected by the Israeli authorities on behalf of the PA under the clearance system.

[23] Total budget commitments from donors amounted to $589 million by the end of 2001. World Bank, "Fifteen Months....

[24] MAS, *MAS Economic Monitor*, No. 6, April 2000; Al-Ayyam, "Interview with PA Finance Minister Salam Fayyad", Ramallah, 6 July 2002 (in Arabic).

[25] According to PCBS, GDP is expected to decline by 4 per cent by the end of 2002 as compared to the previous year, to stand at $3,574 billion. PCBS, "Impact of Israeli..."

[26] PA Ministry of Planning and International Cooperation (MOPIC), "Quarterly Matrix on Foreign Aid", different issues, Palestine.

[27] Ibid.

[28] World Bank, "Aid Effectiveness in the West Bank and Gaza", West Bank and Gaza Resident Mission, Palestine, June 2000.

[29] These projects are funded by the EU, which has accrued US$ 14.7 million in losses as a result of the destruction of its project facilities. World Bank, "Fifteen Months ....

[30] Ibid.

[31] PCBS, General Education Indicative 1994/1995-1998/1999, Palestine, 2001.

[32] In 1999, the PA launched the "National Economic Dialogue" on such issues as identifying the development interests of the private sector and the needed policies for enhancing the role of the private sector in economic development. The PA has also developed a strategic framework for guiding legal reform, "Rule of Law Strategic Development Plan". By mid-2000, the PA had enforced 40 laws with a direct bearing on the economic on business spheres. See UNSCO, Rule of Law Development in the West Bank and Gaza Strip: Survey and State of the Development Effort, Gaza, May 1999.

[33] See UNCTAD. "The Palestinian economy: achievements of the interim period and tasks, for the future". UNCTAD/GDS/APPU/1, Geneva, 19 January 2001; and, World Bank, "West Bank and Gaza: Strengthening Public Sector Management", West Bank and Gaza Resident Mission, 1999.

[34] The PA may share the attributes of a "soft state" in that it lacks the institutional capacity to push through its development agenda. See Myrdal, G., *Asian Drama: An Enquiry into the Poverty of Nations*, New York, Pantheon Books, 1968, chapters 2, 19 and Appendix 4.

[35] R.A. Vadirieso et al., "West Bank and Gaza...", p.22

[36] The underpinnings of the PA reforms are outlined in the "Reform Charter" that was presented by the Palestinian Legislative Council (PLC) to the President in mid-May 2002 following the approval of the Basic Law (constitution) and the judicial legislation. *Jerusalem Times*, May 2002, Jordan.

[37] UNCTAD. "The Palestinian economy...".

[38] Comparisons between sectoral shares of agriculture and other sectors for the pre- and post-1994 periods should be made with caution owing to different statistical methodologies and measurement criteria applied by the Israeli Central Bureau of Statistics and PCBS, respectively.

[39] Under the terms of existing accords, Gaza International Airport is not allowed to operate cargo flights.

[40] Basim Makhool, "Economic growth and employment in the West Bank and Gaza Strip", *Arab Economic Journal*, 27:11, Spring 2002.

[41] See UNSCO, "Report on the Palestinian Economy", Gaza, Spring 2001; and, Palestinian Securities Exchange (PSE), "Market Activity Report: Fourth Quarter ", 2000 at http://www.p-s-c.com.

[42] This has been fully covered in previous UNCTAD studies, in particular UNCTAD. "The Palestinian economy and prospects for regional cooperation". UNCTAD/GDS/SEU/2, Geneva, 30 June 1998; GDS/SEU/3 and GDS/APP/1.

[43] UNCTAD. "The Palestinian economy...".

[44] For detailed discussions on the currency issue and future Palestinian monetary arrangements, see: UNCTAD. "Prospects for sustained development of the Palestinian economy: strategy and policies for reconstruction and development". UNCTAD/ECDC/SEU/12, Geneva, 21 August 1996; "Cooperation..."; and, "The Palestinian economy....".

[45] This highly inefficient and costly "back-to-back" system, in operation at a number of crossing points for many years, is widely regarded as a major impediment to trade capitalization. UNCTAD. "Cooperation...

[46] See Hoddinott, J., "The shift from development to emergency assistance and its impact on poverty and nutrition: a conceptual framework", Washington, D.C., International Food Policy Research Institute, 1999.

[47] UNCTAD's Macroeconomic Simulation Framework (MSF) of the Palestinian economy estimates that such a path can be attained with a significant infusion of external transfers, in the form of investment and aid. Over an 11- years projection period, this reconstruction and reform program would call for a total of around $16 billion in net transfers or an average of $1.4 billion per annum. This is equal to some $10 billion over and above current flows of external aid and investment.

[48] World Bank, "Aid Effectiveness ...".

[49] See Buchanan-Smith and Maxwell, "Linking relief and development: an introduction and overview", *Institute of Development Studies Bulletin* (IDS), Vol. 25; Bruck, T., Fitzerald, S., and Grisby, A., "Enhancing the private sector contribution to post-war recover in poor countries", Working Paper no. 45(1), Oxford: Queen Elizabeth House, 2000.

[50] For a thorough analysis of market dynamism and the evolution of world trade over the last two decades, see UNCTAD, *Trade and Development Report, 2002,* United Nations publication, New York and Geneva, chapter 3.

[51] Shafaeddin, M., (2000), "Free Trade or Fair Trade? An enquiry into the Cause of Failure in Recent Trade Negotiations", UNCTAD Discussion Paper, No. 153, Geneva, December, p.20.